

March 25, 2005

Ms. Jennifer J. Johnson
Secretary of the Board of Governors
Federal Reserve System
20th Street and Constitution Avenue
Washington, DC 20551

Re: Docket #R-1217

Dear Ms. Johnson:

Navy Federal Credit Union provides the following comments in response to the Federal Reserve Board's Advance Notice of Proposed Rulemaking (ANPR) on possible changes to the open-end credit rules under Regulation Z. As the first step of a multi-stage process to reexamine Regulation Z in its entirety, the Board proposes to review the format and content of open-end disclosures as well as the substantive protections afforded by the regulation.

Congress, when it passed the Truth in Lending Act (TILA) in 1968, believed that economic stability would be enhanced and competition among creditors would be strengthened by providing for the informed use of credit. It purported to provide protections against unfair credit practices and require disclosures that would allow consumers to make informed decisions as they shopped for credit products. However, after 35 years of regulatory implementations, legal opinions, staff interpretations, and follow-up statutory and regulatory amendments, TILA's effectiveness remains highly debatable.

We routinely hear complaints from our members about the complexity and volume of mandated disclosures. The Board's ANPR cites a 2001 survey which found that two thirds of those questioned said it was easy to obtain information about credit terms, yet three quarters of the respondents stated that they also found the disclosures confusing and overly complicated. We concur with the remark made by Ms. Julie Williams, Acting Director of the Office of the Comptroller of the Currency, before The Exchequer Club on January 12, 2005 that "just about every major participant in the processes of developing, designing, implementing, overseeing and evaluating consumer disclosures for financial products and services needs to rethink their approach to those tasks."

Ms. Williams elaborated on her concerns as follows, ". . . [I]t is important that disclosures *work* to effectively inform consumers of what they want to know. I worry, however, that this approach is on the verge of breaking down, and if it's not re-focused, more prescriptive legislation and regulation could result. And it's reached that point not because consumers are

getting too little information, but because they are getting *too much* information that's not what they're really after; and because the volume of information presented may not be *informing* consumers, but rather *obscuring* what's most helpful to their understanding of financial choices." We believe she is on target when she proclaimed, "There's a critical element that's been missing from our consumer disclosure rulemaking processes – testing *how consumers interpret* particular disclosures and how to make disclosures *usable* to them." The public policy process has erred in its focus of requiring additional disclosures that do little to ensure that consumers will be able to make informed choices.

Despite the best intentions of both the regulators and those that are subject to regulation, the current approach has not generated a detailed understanding of the information *as it is likely to be interpreted by consumers*. Although this approach may yield a great deal of valuable information (generally provided by financial services professionals, professional consumer advocates, and/or their attorneys), too little emphasis has been placed on ensuring that disclosure information is understood by the consumers to whom it is ultimately directed. We strongly encourage the Board to actively embrace consumer testing of proposed disclosures to facilitate the rulemaking process.

We provide additional comments on selected questions from the ANPR as follows:

Q1. The Board solicits comments on the feasibility and advisability of reviewing Regulation Z in stages, beginning with the rules for open-end credit not home-secured. Are some issues raised by the open-end credit rules so intertwined with other TILA rules that other approaches should be considered? If so, what are those issues, and what other approach might the Board take to address them?

As we stated above, we believe the overall approach for the Board's review should be fundamentally altered to reflect an emphasis on consumer interpretations and usability. We encourage the Board to consider the possible applicability of comments made at this stage to other areas of Regulation Z and recommend that the public be allowed to continue to offer comments on open-end rules even as the agency moves on to other areas of the regulation.

Q2. What formatting rules would enhance consumers' ability to notice and understand account-opening disclosures? Are rules needed to segregate certain key disclosures from contractual terms or other information so the disclosures are more clear and conspicuous? Should the rules require that certain disclosures be grouped together or appear on the same page? Are minimum type-size requirements needed, if so, what should the requirements be?

We strongly encourage our regulators to engage consumers in comprehensive, multi-stage testing to solicit informed comment as to what type of disclosures they find easy to navigate and to understand. For example, information disclosed in a tabular format (similar to information offered in a “Schumer” box or on nutrition labels found on pre-packaged food products) may prove to be easy to understand. However, we believe that “easy to understand” can only be determined with the help of consumers who can compare different disclosure proposals.

We also encourage the Board to solicit informed consumer input when determining whether or not certain key disclosures should be segregated from contractual terms or other information. Only in those instances where consumer testing strongly indicates improved understanding and usefulness do we believe that rules should be drafted to require that certain disclosures be grouped together or appear on the same page. We ask that any proposed changes be subject to the full regulatory request for comment process.

Q3. Are there ways to use formatting tools or other navigational aids for TILA’s account-opening disclosures that will make the disclosures more effective for consumers throughout the life of the account? If so, provide suggestions.

In this request for comment, the Board mentions a “table of contents” box that could highlight for readers where specific terms might be found. We urge the Board to carefully consider this approach and subject this proposal to a rigorous examination before imposing any new requirement. A table of contents box would prove onerous to create and even harder to amend as disclosures change over time. We are not convinced that the corresponding benefits to consumers outweigh the burden of having to navigate more text.

Q6. How can formatting tools and navigational aids make the periodic statements more effective for consumers?

Navy Federal encourages the Board to amend the Regulation Z Official Staff Commentary to clarify that a financial institution may discontinue sending statements to a consumer if his or her open-end credit account is considered “inactive” as defined by the institution. We believe such a change would improve consistency in the various periodic statement requirements financial institutions must follow. For example, the Board has previously approved similar language in the Regulation E Official Staff Commentary (12 CFR 205.9(b)-3.) to specifically allow financial institutions to discontinue sending statements for inactive accounts. Further, many financial institutions consider accounts “inactive” if they no longer have current contact information (e.g., mailing addresses or telephone numbers) for those account holders. Continuing to send statements to those consumers, as required by Regulation Z, could have the unfortunate effect of increasing their chances of identity theft.

Q12. In developing any proposed revisions or additions to the model forms or clauses, the Board plans to utilize consumer focus groups and other research. The Board is aware of studies suggesting that, for example, bolded headings that convey a message are helpful, but using all capital letters is not. Is there additional information on the navigability and readability of different formats, and on ways in which formatting can improve the effectiveness of disclosures? How can the content of disclosures be improved or simplified to enhance consumers' understanding of the cost of credit?

While we generally support regulations that allow financial service providers to provide disclosures of their own form and style, we believe that regulators can do much more to develop effective model language and forms. We applaud agency efforts to more fully involve consumers in any proposed revisions or additions to the model forms or clauses. As we stated above, we encourage regulators to draft and thoroughly test any new or amended model disclosures so that financial service providers may take advantage of that information.

Q23. Have changes in the market and in consumers' use of open-end credit since the adoption of TILA affected the usefulness of the historical APR disclosure? If so, how? The Board seeks data relevant to determining the extent to which consumers understand and use the historical APR disclosed on periodic statements. Is there data on how disclosure of the historical APR affects consumer behavior? Is it useful to consumers to include in the historical APR transaction charges such as cash advance fees and fees to transfer balances from other accounts?

Navy Federal strongly supports disclosure of the fees that are part of the historical APR calculation in dollar terms on periodic statements; however, we encourage the Board to eliminate the requirement to incorporate these fees into an historical APR calculation for the statement period. We believe that the historical APR is confusing to consumers because it may reflect a much higher APR than the APR that was originally disclosed at account-opening. While this discrepancy between the originally disclosed APR and the APR on a consumer's periodic statement can be explained if the consumer incurred fees during the statement period, we believe that most consumers are confused by the differences between the two APRs.

Further, we believe disclosure of the historical APR may actually prompt consumers to seek credit with different terms. For example, if a consumer incurs a charge that is incorporated into the historical APR for a specific statement period, the historical APR disclosed on the statement may be substantially higher than the APR that was originally disclosed to the consumer. Such a difference may prompt the consumer to seek credit elsewhere at a rate lower than the historical APR, but at a rate higher than the APR the consumer would have otherwise received. Navy Federal encourages the Board to consider eliminating the requirement to disclose an historical APRs on consumers' periodic statements.

Q30. Explanations of balance calculation methods are complex and may include contractual terms such as rounding rules. Precise explanations are required on account opening disclosures and on periodic statements. Should the Board permit more abbreviated descriptions on periodic statements, along with a reference to where consumers can obtain further information about the calculation method, such as the credit agreement or a toll-free telephone number?

Though information on balance computation methods can be very complex and wordy, we are not convinced that resorting to abbreviated descriptors will make them more understandable. We suggest a different approach. We believe that many consumers simply do not want this type of information; for them, requiring the disclosure of this information means only that additional language must compete for their attention. Still, this information needs to be available to consumers when they have questions about the terms of their credit agreement. We suggest that the Board seek to allow financial service providers to remove this information from disclosures, but require that they include disclosure language stating that the information is available upon request.

Q31. Is it appropriate for the Board to consider whether Regulation Z should be amended to require: (1) periodic statement disclosures about the effects of making only the minimum payment (such as, disclosing the amortization period for their actual account balance assuming that the consumer makes only the minimum payment, or disclosing when making the minimum payment will result in a penalty fee for exceeding the credit limit); (2) account-opening disclosures showing the total of payments when the credit plan is specifically established to finance purchases that are equal or nearly equal to the credit limit (assuming only minimum payments are made)? Would such disclosures benefit consumers?

While we are certain that consumers intuitively understand that the less they pay on their credit card balance, the more they will owe later, additional disclosure language may spur them to place greater emphasis on maintaining smaller credit balances. We are concerned, however, that additional disclosure language may be presented in a manner that will not provide consumers with the information to help them make properly informed decisions. For example, Congress is currently negotiating the passage of S. 256, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which would amend TILA and require that financial institutions include a minimum payment warning in their periodic statements. In its current form,¹ financial institutions would be required to include language describing examples that

¹ S.256. the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* as referred to House Judiciary Committee after being received from Senate. §1301. “*Making only the minimum payment will increase the interest you pay and the time it takes to repay your balance. For example, making only the typical 2% minimum monthly payment on a balance of \$1,000 at an interest rate of 17% would take 88 months to repay the balance in full. For an estimate of the time it would take to repay your balance, making only minimum payments, call this toll-free number: XXXXXX.*” (the blank space to be filled in by the creditor).”

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simply would not apply to the majority of consumers. Though well-intentioned, we are concerned that disclosures of this type could be viewed by consumers as little more than additional language that competes for their attention. If this legislation becomes law, we urge the Board to seek a remedy to allow financial service providers the option of drafting succinct customized disclosures that reflect the actual circumstances of each consumer.

We question the value of account-opening disclosures described in the second part of this question. However, if thorough consumer testing indicated significant value, we ask that any such proposed rule be subject to the full regulatory comment process. Finally, if the Board determines these requirements are effective, it should allow ample time for lenders to implement the new provisions.

Q43. The Board solicits comments on whether there is a need to revise the provisions implementing TILA's substantive protections for open-end credit accounts. For example, are the existing rules adequate, and if not, why not? Are creditors' responsibilities under the rules clear? Do the existing rules need to be updated to address particular types of accounts or practices, or to address technological changes?

Navy Federal generally supports the scope and direction of the Truth in Lending Act and believes that our policy-makers have crafted a body of consumer protection law that provides substantive consumer protections. The law has provided protections against unfair credit practices and required substantial disclosures intended to allow consumers to make informed credit decisions. However, we believe the mandated disclosures are not fully effective in providing consumers with the ability to make the "informed" choices as Congress had originally envisioned.

We conclude that regulators must focus on the steps they can take to feature consumers' needs and abilities more prominently in the rulemaking process. In this and future reviews, we encourage the Board to actively engage consumers in testing proposed disclosures to enhance the value of the regulatory process. Navy Federal Credit Union appreciates the opportunity to comment on the scope and direction of the reexamination of Regulation Z.

Sincerely,

A handwritten signature in black ink that reads "Cutler Dawson". The signature is written in a cursive, flowing style.

Cutler Dawson
President/CEO

CD/pm